Audit's
MONTHLY NEWS ANALYSIS OF SECURITIES OF REAL ESTATE INVESTMENT TRUSTS
Realty Trust Review

Monday, October 11, 1971 Vol. II, No. 13

TRUST SHARES FOR YOUR ATTENTION

INDUSTRY TRENDS

REALTY TRUST GATHERING TO FOCUS ON PHASE II AND BEYOND

The role of real estate trusts in the 1970s will be explored at the National Association of Real Estate Investment Funds (NAREIF) convention Oct. 22 in San Francisco. R. Gene Conaster, vice president-planning for Bank of America, will describe the economic environment of the 1970s in which REITs will operate, including the impact of President Nixon's Phase II plans. A panel of trust executives will present their views on this topic to registrants. That panel, chaired by Robert Volk, chairman of the adviser to Unionamerica Mortgage & Equity Trust, includes Kent L. Colwell of Mortgage Trust of America; James P. Cozzens, National Mortgage Fund; Thomas J. Hartigan, First Union Real Estate Equity & Mortgage Investments, and B. Francis Saul II, of B. F. Saul Real Estate Investment Trust. In addition, a panel of investment bankers led by W. Peter Slusser, partner of Shields & Co., will examine the REITs and a panel of security analysts led by your editor will report on their viewpoint of the industry. Workshop sessions open only to NAREIF members and associates will be held Oct. 21. Registration fee is $50 and may be made through the NAREIF office, 1101 Seventeenth St. N.W., Washington, D. C. 20036.

Our book THE REAL ESTATE TRUSTS: AMERICA'S NEWEST BILLIONAIRES will be off the presses Oct. 20. Copies will be mailed to subscribers who took advantage of our pre-publication offer on or about that date from our printers' office in Hallandale, Florida.

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Published twice monthly on the second and fourth Fridays *Subscription $84 annually* *Group rates on request*

NEW TRUST OFFERINGS DWINDLE BUT SECONDARIES ALREADY SURPASS 1970

The slowing of new equity capital (stock and convertible debentures) raised by new trusts was noticeable in the quarter just ended. The $82.3 million raised by new trusts going public was only 17% of the $471.5 garnered by newcomers in the first half of 1971. This is a logical outcome of the heavy flow of new trusts over the previous two and a half years when so many organizations were formed based on institutional credit capability and real estate knowledge and connections for originating loans. It thus seems that most organizations that will form new trusts have already done so. Further proof would be that there are only about four new trusts of significant size in registration.

The flow of capital into existing trusts remained respectable. Third quarter placements of $127 million equalled nearly 44% of the $291.5 million for the first half. Moreover, present trusts have $182.3 million in registration which may come to market during the current quarter. The funds were well distributed among the group which was made up of mostly smaller, non-bank affiliated trusts. In addition to natural growth by the issuers, there was undoubtedly a desire to increase the size and hence borrowing capability. Comparison to first-half activity looks even better when considering Chase Manhattan's $100 million accounted for over one third of the total.

We are now close enough to year end to get a preliminary picture of the year and see how 1971 financings compared to prior years. Total funds raised by trusts will be down from 1970, we estimate $1,265 million from $1,599 million. The drop comes from new trust offerings which look like $725 million for 1971 compared to $1,310 million last year. Secondaries by existing trusts should raise about $540 million this year compared with $289 million in 1970. The nine-month total here has already surpassed all of 1970.

SUMMARY OF TRUST OFFERINGS (Mil. $)

	1969	1970	1971 (9 mos.)
Initial-shares	$ 880.8	$ 949.0	$428.8
-converts	50.0	361.7	125.0
Initial-Total	930.8	1,310.7	553.8
Secondary-shares	67.2	37.6	23.0
-converts	151.5	252.6	340.0
Secondary-Total	218.7	288.7	363.0
TOTAL	$1,149.5	$1,599.4	$916,8

There was a disturbing aspect in the uniform use of warrants in the past quarter's offerings. Most convertibles were sold at insignificant premiums to market, yet underwriters thought it necessary to sweeten the deals with warrants. The exceptions were Barnett and Guardian which sold straight debt to be used toward warrant exercise--sometimes called "synthetic convertibles"--which works out to almost the same thing as current equity sales at current prices but with a smaller commission of about 3½% - 4½%. Normally warrants provide future financing but at prices related to recent market rather than future market when shares might be higher.

The credit and equity markets were generally receptive in recent months which helped create a good atmosphere for trust offerings. Naturally, the strong bond markets of recent weeks and healthy stock market will make new offerings even easier.

However, the side effect could be higher commercial paper placement perhaps even to the point of increased leverage ratios. This could lessen equity reliance. First Mortgage, for instance, has reached a 1.6-1 leverage ratio over capital funds. This is one of the highest leverage ratios reached in recent years.

CAPITAL RAISED BY TRUSTS, THIRD QUARTER 1971

Trust	Date	--Unit*-- Sh/Wt/Deb	Price	---Proceeds (Mil.$)--- Equity	Debt	Total
Initial offerings						
Arlen Property Inv.	9/2	1/0	16½	$16.5	---	$ 16.5
Hamilton Investment Tr.	7/22	1/1	20	25.0	---	25.0
Hospital Investors	8/17	1/1	20	25.0	---	25.0
Property Capital	7/14	1/0	21	15.8	---	15.8
Totals				$82.3		$ 82.3
Secondaries (Capital) Third Quarter						
American Century Mtg. Iv.	7/7	0/23/a	1000	---	$ 22.0	$ 22.0
Barnett Mortgage Tr.	9/23	0/40/as	1000	---	20.0	20.0
Colwell Mortgage Tr.	9/9	0/20/a	1000	---	15.0	15.0
First Penn. Mtg. Tr.	8/19	0/9/a	1000	---	30.0	30.0
Guardian Mtg. Inv.	7/21	0/30/as	1000	---	30.0	30.0
Median Mortgage Inv.	9/16	0/5/b	100	---	25.0	25.0
Totals					$127.0	$127.0
Straight-Debt						
First Mortgage Inv.	7/1	0/0/as	1000		$ 25.0	$ 25.0

*Principal amount of debentures included in units as follows: a-$1000, b-$100, s-straight debt. First Pennsylvania unit given in number of shares exercisable, 18 warrants for 9 shares. Guardian and Barnett debentures can be used toward warrant exercise.

Existing trusts in registration

Trust	Type	Equity	Debt	Total
Alison Mtg. Inv. Tr.	Convert. debentures & warrants	---	$ 25.0	$ 25.0
Beneficial Std.	Convert. debentures & warrants	---	15.0	15.0
First Fidelity Inv. Tr.	Shares	4.5	---	4.5
Great Amer. Mtg. Inv.	Convertible debentures	---	25.0	25.0
Lomas & Nettleton M.I.	Shares	37.8	---	37.8
Mass Mutual Mtg. & Rlty.	Convertible debentures	---	50.0	50.0
Realty Income Tr.	Convertible debentures	---	25.0	25.0
Totals		$42.3	$140.0	$182.3

Equity offerings based on recent market price.

New trusts in registration

Continental Illinois Properties: $100 million of shares. This is an equity trust formed by the Continental Illinois Realty group and its bank holding company parent.

Builders Investment Group: $50 million of shares and warrants. This is an equity trust formed to acquire income producing properties from 16 unrelated builders, some now existing and from those to be built by said builders over the next three years.

NJB Prime Investors: $25 million of shares and convertible debentures. This is a short-term trust formed by New Jersey Bank and Prime Equities.

Gulf South Mortgage Investors: $15 million of shares and warrants. This is a short-term trust.

THREE WEST COAST BANK TRUSTS PURSUE VARIED PATHS

Three of the five giants of West Coast banking are already deeply committed to realty trust sponsorship and pending acquisition of Ralph C. Sutro Co., adviser to Sutro Mortgage Investment Trust, would put a fourth, Crocker-Citizens National, into the business as well. Since only two of the seven largest New York City banks have chosen to sponsor trusts, California easily qualifies as the heart of trust territory. (To cinch the case, the adviser for Continental Illinois Realty is also headquartered in Los Angeles.)

The five West Coast giants, along with the seven New York City banks, dominate the ranks of the top 15 U.S. banks and thus the intersectional jostling among the giants is of more than casual curiosity. Trusts sponsored by West Coast banks include:

BankAmerica Realty Investors, whose adviser is an affiliate of Bank of America, largest U.S. bank. With nearly $120 million assets, BARI ranks well up in the ranks of major trusts.

Wells Fargo Mortgage Investors, advised by an affiliate of the San Francisco bank that is No. 11 in size nationally. WFMI ended its July 1971 year with $96.9 million assets.

Unionamerica Mortgage & Equity Trust, advised by a subsidiary of the holding company for Union Bank, No. 15 nationally. UMET held $44.7 million assets at the end of August.

Sutro Mortgage Investment Trust, a $49 million trust, would come under the wing of Crocker National Corp., No. 12 in U.S. banking ranks, if the pending acquisition is completed.

The only absentee is Security Pacific National Bank of Los Angeles, second largest in the West and No. 9 nationally with $7.0 billion deposits.

But beyond their cradle among the California giants, the trusts have very little similarity in investment objectives or in relations with their banking cousins. BankAmerica is establishing a record as an aggressive long-term mortgage and equity trust, while Unionamerica and Wells Fargo operate in the short-term market. Unionamerica however holds a portfolio yielding an aggressive 12% currently while Wells Fargo's portfolio yields only 9.48%. Part of this gap stems from the fact that Wells Fargo ended its first year in June with about $42 million in participations from its bank, or about 32% of its $132 million commitments. Sutro was discussed August 16. Here's a closer look at the other three California trusts:

BankAmerica Realty Investors is carving out a role as a provider of equity and loan packages which essentially would give a developer 100% financing. Long-term commitments of $84 million were made during the trust's first year of operations ended in July, with a minimum 10.5% cash yield to the trust projected from these investments. Since many deals are structured as land purchase or project purchase and leasebacks, the return thus is a lease payment exempt from California's strict 10% usury law. Thus the trust has been able to commit $58.3 million--or nearly 70% of

long-term commitments--in its home state of California, territory sidestepped by many short-term trusts. Other commitments are in Colorado, Arizona, Illinois and Florida.

Only about $15.1 million of these long-term commitments were funded in the first year, with the remaining $69 million due for funding over the next two years. Another $103.5 million was invested in short-term construction and development loans at July 31, a loan category in which BARI intends to remain active. But the benefits to BARI shareholders should stem from its long-term investments and thus the nature of its investment packages should be examined.

About $10.7 million of the commitments are straight equity investments by the trust, with the future purchase of an equity in part of the Del Amo Financial Center in Los Angeles for $6.1 million the largest single purchase. At Del Amo, BARI will be purchasing 350,000 sq. ft. of space that is 96% leased--in the face of a soggy rental market--and will own adjoining land which can be developed to an ultimate one million sq. ft. over the next five to ten years. BARI will assume a $10.2 million non-recourse mortgage in the transaction, thereby increasing leverage on its investment.

The remaining $74 million of long-term commitments are all land purchase or project purchase and leaseback transactions. In land purchase-leasebacks, the trust will own the land beneath projects while leasing buildings--and their depreciation--to unaffiliated persons, often the developer. Project purchase and leasebacks are similar, except that the trust will own the buildings and their depreciation. Hence at some future time the trust will be reporting depreciation cash flow in addition to ordinary earnings, although depreciation cash flow will not be major for some time. In a typical deal, BARI will buy the land and/or building and then provide its own long-term mortgage financing. The mortgage has no prepayment penalty, so that the loan can be refinanced to other lenders should rates move lower, with the trust and the developer/operator sharing in both refinancing proceeds and the lower constant annual debt service payment. And while BARI's deals have not matured to the point of refinancing, some refinancing of income properties has already taken place in California, with reductions in the constant of about 1.25% reported.

In addition to this form of inflation protection, typical BARI deals also provide for the trust to receive between 15% and 30% of any increases over stabilized, or projected, rent roles. On occasion BARI will also provide construction financing to its projects, thus completing the picture of a full-service trust.

In addition, the trust intends to remain secondarily invested in short-term mortgages, essentially on a leveraged basis through funding with bank borrowings or commercial paper. At year-end the trust had $16.19 million of commercial paper outstanding, sold directly to outside investors through the B. of A. investment operation. Bank lines of $90 million are essentially used as back-up lines for commercial paper, with B. of A. providing $50 million and Eastern banks the remainder. While terms of these lines are not disclosed, the trust carries very low cash balances ($253,000 at year-end) indicating very low compensating balance requirements.

The trust is capitalized at July 31 with $42.04 million bank borrowings and commercial paper, $14.00 million of 6-3/4% debentures convertible at $21, and $58.60 million equity represented by 3,107,000 shares. For the year the trust earned $1.69 per share (or $1.63 fully diluted), equal to a return of 8.5% on fully converted book value of $19.24 per share. July quarter earnings were $0.45 (or $0.43 converted) per share. During the year dividends amounted to $1.60 per share, with the final quarter dividend of $0.55/share including an unspecified year-end final payout. Dividends will approximate earnings during fiscal 1972. For fiscal 1972, we believe

fully converted earnings can rise to about $1.80 per share, with the July 1972 quarter at the rate of about $1.95/share. The portfolio is conservative and well managed and the shares should be rewarding for longer-term investors.

Wells Fargo Mortgage Investors has gotten off to a slower start than many had expected because the staff-building process for the adviser, Wellsco Real Estate Management Corp., stretched out longer than expected. Since Wells Fargo Bank has never been noted as a major construction lender, the trust brought in Carl E. Reichardt from Union Bank, a savvy construction lender, to lead the adviser. Reichardt has now assembled a young, highly qualified advisory team drawn from the ranks of experienced construction lenders, and the adviser is expanding its commitment volume rapidly.

At year-end June 30, $92.6 million of loans had been funded out of $132 million in total commitments. The adviser originated directly $90 million of these commitments during the year, with $42 million coming from the bank affiliate. The trust aims to generate commitments of $1 million or more from major builder-developers, a strategy that brings the trust into competition with trusts like Continental Illinois Realty and Chase Manhattan Mortgage. At year-end, commitments were 39% in apartments, 23% in single family housing and 20% in office buildings. Smaller categories include 5% mobile home parks, 5% industrial buildings, 5% hotels and motels. About 42% of commitments are in California, reflecting the bank's initial contribution. Other major states include New York, 16% and Arizona, 15%.

The trust is also shifting its emphasis into purchase-leasebacks similar to those sought by BankAmerica Realty, with about $8.85 million of such commitments made by year-end. In purchase-leasebacks, WFMI is aiming at major transactions on standard income properties with operating histories, and where the building provides about a 140%-150% debt coverage from cash flow. Repurchase options are built into the transaction if local custom requires them.

Although the bulk of investments are coming from advisory contacts with builder-developers, the trust also reviews proposals from Sonoma Mortgage Co., a northern California mortgage banking subsidiary of the bank. Sonoma has strong relations in Hawaii and Texas in addition to its northern California base, and is especially active in FHA project loans, all areas the affiliated bank has not handled traditionally. The relationship thus increases the trust's flow of investment opportunities materially. Investments appear to have been well underwritten, and the trust has never had a past-due interest payment.

For the first half of its initial year, the trust operated without leverage. Since then it has moved into the commercial paper market, bolstered by a prime rating from the National Credit Office, and at the end of June had $26.4 million in commercial paper outstanding. This has now increased to about $43 million outstanding as commitments are taken down. The trust sells its paper direct through the bank's money desk, and although the parent holding company had announced its intention of guaranteeing the trust's paper, it has not done so. Back-up bank lines amount to $55 million, with Wells Fargo Bank providing $30 million and the remainder by New York and Philadelphia banks. All lines are at the prime rate with varying compensating balances.

The trust hopes to move from its present 0.67-1 leverage ratio to a 1-1 ratio by June 1972. We expect this targeted portfolio of about $135 million to yield somewhat more than the current 9.48%, perhaps as much as 50 basis points higher. With leveraging at favorable rates, earnings could move up to a $1.60-$1.65 annual rate by next June, vs. $1.44 now. WFMI's net spread widened to 2.68% in the June quarter and

a continuation of this spread could add $0.20/sh. to our estimates. Aggressive investors may not find the shares to their liking but conservative investors may find some very comfortable gains ahead over the intermediate term.

Unionamerica Mortgage & Equity Trust is ending the second year of its operations this November with an impressive record of earnings growth. Realized portfolio yield has been maintained at high levels, averaging 13.12% for three quarters to August, a tribute to the construction lending expertise which Union Bank brought to the operation. While we expect some slight decline in yields for near-term quarters, the erosion should not impair earning power.

UMET concentrates in construction loans, with apartment buildings making up about half the loan mix and office structures about one-third. The trust originates about 75% of current loans through correspondent mortgage bankers, with the remaining 25% coming from in-house work. Commercial banks are not used as a loan source, although management does not rule out the possibility in the future. In addition the trust has recently completed two purchase-leaseback transactions.

The trust has moved aggressively into commercial paper, and had $20.57 million outstanding at the end of August, giving UMET a 0.87-1 debt/equity ratio. Management believes it can attain a 1.5 or 2.0-1 ratio before requiring new financing. With a $23.5 million equity base, this implies portfolio growth from the present $42.4 million to perhaps $55-$60 million before new funding might be needed. Back-up bank lines are $23.75 million at present, and the trust does not rely upon Union Bank for bank lines. Instead the trust works independently with about 10 banks, holding $2.5 million lines each with such banks as Chemical and Franklin National in New York, First Pennsylvania and Provident National in Philadelphia, Mercantile Trust of St. Louis, First National of Dallas and First National of Atlanta.

UMET is able to use some part of escrow balances from Western Mortgage Co., second largest U. S. mortgage banker that is also a subsidiary of parent Unionamerica Corp., to reduce cash balances under its borrowing agreements. Indicated borrowing costs rose slightly in the August quarter to 6.25% from 5.88% in the preceding quarter, but lower expenses kept the net spread on borrowed funds (i.e., net income after all management and interest costs) at 4.05%, among the highest in the industry.

For the nine months through August, earnings were $1.68/sh., up 66% from the $1.01 of the prior year. For the year ending November, we expect about $2.30 per share. Assuming continued favorable spreads on leveraged funds, earnings could reach the $3.00 per share level by the August quarter of 1972. At present prices of $31.50, the shares are conservatively valued at 13.1 times current $2.40 earnings with a yield of 7.6%. The shares have appreciation potential for aggressive investors.

QUESTIONS OF UNIVERSAL INTEREST FROM SUBSCRIBERS ANSWERED

Q. What is happening with the proposed merger between *Security Mortgage Investors* (18-ASE) and *Medical Mortgage Investors* (28 5/8-OTC)? What should holders of these securities do?

A. The proposed combination of these two trusts has been expanded to include $69 million of mortgages from General Electric Credit. The resulting trust will have $135 million in assets with more prestigous sponsorship and greater loan originating and leveraging capability. The details were spelled out as follows: SMI shares will be exchanged share-for-share in the combined trust, each MMI share will receive 1.75 of the new shares plus half a warrant to buy one additional share and GE Credit Corp. will receive $61 million cash, 350,000 trust shares and warrants for

another 250,000 shares. To raise the funds for the purchase from GE Credit, the trust will sell publicly $50 million of debentures plus warrants to purchase 1,000,000 shares.

The key sponsors will be General Electric Credit and North American Acceptance (which currently owns 45% of the present Security Mortgage Investors). The trust will have first refusal rights to the purchase of certain mortgage notes from North American and certain long-term mortgages from GE Credit. The adviser will be a newly formed management company controlled by Smith Barney & Co., investment bankers, but the equity of the adviser will also be held by GE Credit, North American and American Medicorp. The rational behind the combination is the complimentary nature of the portfolios and the aforementioned originating and leveraging ability. Security is mainly in intermediate-term, and also short, first or second mortgages to homeowners and GE Credit is in intermediate-term second mortgages on homes. Medical is nearly half in long-term mortgages on health facilities but lacks strong short-term capabilities. The addition of the GE group appears to add enough in size and stature to permit really big leverage. The pro forma combination of Security and Medical would bring the most recent annualized earning power to about $1.06 a share for the new trust from $0.92 per Security share and $2.20 per Medical share. Medical holders would receive less earnings per share immediately but higher market value of a lower multiple stock. Leveraging of the additional mortgages brought in from GE Credit could add significantly to earnings as the quality of the sponsor-guaranteed paper will permit a higher ratio than other trusts. It is premature to publish estimates prior to release of registration statements and proxies to Security and Medical shareholders in mid-October. Both shares are strong holds pending this most significant new trust combination.

Q. What is the status of the pending purchase of Western Mortgage Investors' adviser by State Street Boston Financial?

A. State Street has just terminated negotiations after long analysis. Western is a very small operation that has not been able to grow. In recent months, Western built up construction loan commitments to $11 million but the level funded is little higher at $4.8 million. Rapid repayments have been the main depressant. In our coverage July 12, we cautioned a management change was not itself a good reason to buy a trust but speculative value, below book, existed here. Since the change did not come, near-term appeal is very limited.

PORTFOLIO I
LONG TERM, INFLATION PROTECTION

Sh.	Issue-Ann.	Div.	Orig. price	Mkt. 10/5	Mkt. Val.
800	Gen.Growth	-0.92	$23.13	32.50X	26,000
400	US Lsg. RE	-1.08	22.13	23.63	9.452
700	Penn. REIT	-0.85	12.50	12.50	8.750
750	Rlty.Inc.Tr	-1.20	17.13	15.25	11,438
600	Saul (B.F.)	-1.28	19.75	21.13	12,678
400	Wash. REIT	-0.96	12.63	11.00X	4,400
600	GREIT Rlty	-1.60	18.25	19.25	11,550
200	BankAm.Rlt.	-2.20	28.75	28.25	5,650
700	Mob.Hm.Com.	-0.47	9.75	8.75	6,125
300	Cabot C&F	-1.60	22.00	28.00X	8,400
		Mkt. value			104,443

Cash, end of month (incl. div.)	5,384
Net asset value	109,827
Net change in month	+7,648
% change	+7.5%

PORTFOLIO II
INTERMEDIATE TERM, AGGRESSIVE

Sh.	Issue-Ann.	Div.	Orig. price	Mkt. 10/5	Mkt. Val.
700	Alison Mtg.	-2.28	$21.00	26.88	18,816
400	Assoc.Mtg.	-2.40	29.38	28.00	11,200
300	Cont. Ill.	-2.48	32.12	36.00	10,800
450	Larwin MI	-2.36	24.15	33.38	15,021
200	Guard. MI	-3.04	33.50	43.75	8,750
300	Grt.Amer.M	-2.04	26.63	31.38X	9,414
200	First Mtg.	-2.24	32.38	30.25	6,050
200	No.Amer.M.	-2.20	28.00	34.00	6,800
100	Am.Cent.	-2.32	26.00	27.75X	2,775
400	Fidelity M.	-2.00	20.00	22.88	9,150
200	Cameron-Br.	-2.44	29.50	34.25	6,850
300	Sutro Mtg.	-1.60	19.38	24.00X	7,200
100	Cont. Ill.	-2.48	33.38	36.00	3,600
				Mkt. value	116,423

Cash, end of month (incl. div.)	2,368
Net asset value	118,791
Net change in month	+7,195
% change	+6.4%